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Income Flows: Introduction, Meaning and Objectives of Income, Factors of Production

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Introduction

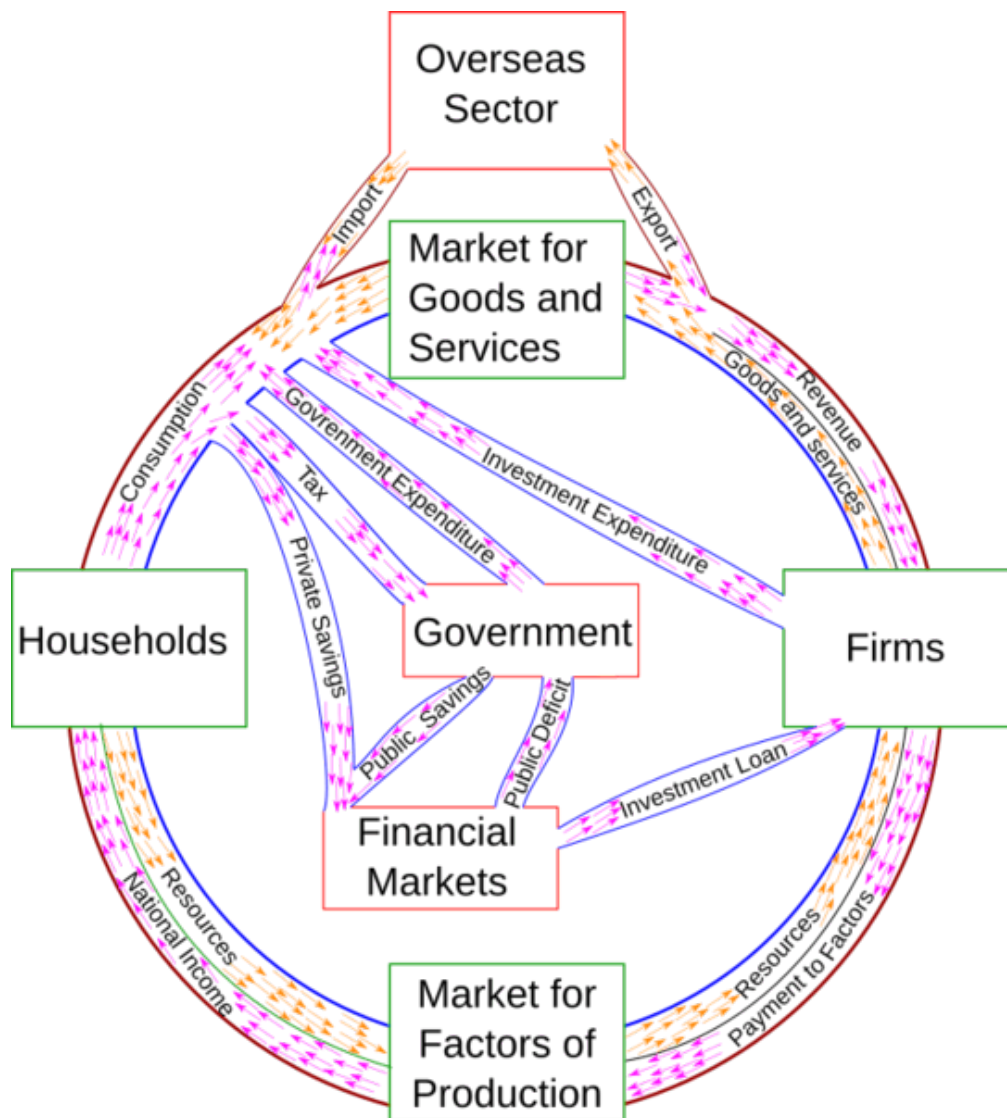
National income is a very essential economic concept. Economics has a specific meaning. It contains two words national and income. That all words have specific meaning in economics.

Meaning of Income

- People receive income from many sources. They may be received wages from their employers, interest on lending money, receive gifts, donations etc. from others. By doing business in market they earn profit.
- For receiving some of these incomes, one has to give something in return. When one receives a gift or a donation, he or she has not to give anything in return. It means that all income receipts are not of the same type.
- Accordingly, in national income accounting we distinguish between two types of incomes:
 - **Factor Incomes**
 - **Non-Factor Incomes**

Factor Incomes

The term factor means factor of Production. There are four factors of production: **Land, Labour, Capital, and Entrepreneurship**. The owners of these factors of production sell the services of their factors to the production units. The production units in turn pay the price for factor services purchased by them from the factor owners. This price is the **factor cost** to the production unit and factor income to the owner of the factor of production. A worker earns income called **wages** in return for the labour services rendered. A landowner earns rent by allowing the use of his land to the production units. The owner of capital earns **interest** by lending his funds for investment to the production units. The owner of the production unit earns **profit**.



Non-Factor Incomes

These are certain money receipts which do not involve any sacrifice on the part of their recipients. The main examples are the gifts, donations, charities, taxes, fines, etc. No sale or provision of any factor service is involved in getting these incomes. These incomes are also known as Transfer Incomes because such incomes merely represent transfer of money without any good or service

being provided in return for the receipts. National income does not include these incomes. National income includes only the factor incomes.

Objectives

- Distinguish between factor incomes and non-factor incomes.
- Explain the meaning of the four factors of production and the type of factor income accruing to each of them.
- Explain the meaning of a production unit.
- Explain the basic economics activities of production, consumption and investment.
- Distinguish between money flows and real flows.
- Distinguish between a closed economy and an open economy.
- Explain the sectorization of an economy into production units, households, general government, capital and the rest of the world sectors.
- Explain the various money and real flows among the sectors.

Who Generates Factor Incomes?

Main source of generates factor income is production unit. If there is no owner to start the factory; no land to build the factory; no money to invest the Worker cannot produce the goods. It is the joint effort of the **four** factors of production i.e.. the land labour capital and entrepreneur which is required to produce a good or a service. For producing a good it's a combination of workers, the land, the finance and the owner who brings together all these factors of production.

The Four Factors of Production

The four factors i.e.. land, labour, capital, entrepreneurship is the main pillars of production. Joint efforts of this factors of production create production of any goods or service.

Labour

Labour refers to the effort that humans contribute to the production of goods or services. A worker requires both physical and mental efforts which are not separable. Different job requires more or less physical and mental labour. For example, a worker who is operating a machine as a routine may be doing more of physical labour than mental labour. On the other hand, an accountant who is looking record of the machine may be performing more of mental labour than physical labour. The remuneration paid to the workers is popularly termed as '**wages and salaries**'.

Land

Land is the surface of earth. Land is vital part of factor of production which used in economics as a 'natural resources. Land's surface is used for agricultural, industrial, residential and other purposes like rivers, dams, bridges etc. Below the surface are used for the mineral deposits, water streams, etc. Historically, when land was (available in plentiful) abundant, there was no need to pay any price for' owning land. But as land became scarce sale and purchase of land started. Those who owned land started charging payments for the use of the land owned by them. Such a remuneration accruing to the landowner is termed as **rent** in national income accounting.

Capital

Capital includes all the elements which used to produce goods or services. Man-made assets used for producing a good or a service like structures on land, machines, equipment, vehicles, stock of materials etc. The main difference between land and capital is that land is a free gift of nature while capital is produced by man. Land cannot reproduce but we can reproduce capital. The remuneration accruing through the capital is termed as interest in national income accounting.

Entrepreneurship

Entrepreneurship or enterprise is needed to combine the other three factors of production. Refers to the initiative taken by a person or a group of persons in starting and organizing a business and take upon their shoulders all the good and bad consequences of doing so. The good consequence of a business is the profit it earns. The one who takes the initiative is termed as 'entrepreneur'. The remuneration accruing through the entrepreneur is termed as profit in national income accounting.

Production Unit

With the use of these four factors of production owner can produce goods or services. Each business requires the services of all the four factors of production. The factories, shops, offices, schools, colleges, service centres, hospitals, railways, radio station, government offices, police departments etc. are all examples of production units which produces either a good or a service.

The basic function of a production unit is to produce goods and services

- Purchasing goods and services from other production units and
- Hiring the services of the four factors of production.
- The two types of costs are respectively called
 - Intermediate costs and
 - Factor costs.
- The goods and services so produced, in most cases, are sold in the market. The receipts from sales are used by the production unit for meeting the two types of costs i.e.. intermediate cost and factor cost. For the factor owners these factor costs are factor incomes, as such factor cost is nothing, but the factor incomes generated by the production unit. Through this factor of production income is generated by the owner. The owner of labour gets wages, more appropriately termed as compensation of employees. The owner of land gets **rent**. The owner of capital gets **interest** the entrepreneur gets **profit**.

Basic Economic Activities

- There are many other economics activities other than Production. For satisfy want of people it requires to produce goods and services. The use of goods and services for satisfaction of wants is called consumption. It will include all goods and services purchased by households. Like, food items, clothes, shoes, vehicles, TV sets, radios, furniture etc.
- For acquis of goods and services for use in the production process is called capital formation or investment. So, there is not one but three economic activities i.e.. production, consumption and investment.

- Production, consumption and investment are interrelated and interdependent. The interrelation is clear from the fact that goods and services produced are either used for consumption or for investment: consumption and investment no production activity will be undertaken. Generating the income flows in the economy these three economic activities are responsible.